

**POLICEMEN'S ANNUITY AND BENEFIT  
FUND OF CHICAGO**

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**(Component Unit of the City of Chicago)  
Financial Statements  
For the Years Ended December 31, 2008 and 2007**

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**  
(Component Unit of the City of Chicago)  
December 31, 2008 and 2007

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## REPORT OF INDEPENDENT AUDITORS

Board of Trustees  
Policemen's Annuity and Benefit Fund of Chicago

We have audited the accompanying statement of plan net assets of the Policemen's Annuity and Benefit Fund of Chicago (the "Fund") as of December 31, 2008, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Fund as of and for the year ended December 31, 2007, were audited by other auditors whose report dated May 15, 2008, expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Policemen's Annuity and Benefit Fund of Chicago as of December 31, 2008, and the changes in plan net assets for the year then ended in conformity with accounting principles generally accepted in the United States.

The accompanying management's discussion and analysis and the required supplementary information as listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board ("GASB"). We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and we express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The other supplementary schedules of administrative expenses, consulting costs, and investment fees are presented for the purpose of additional analysis and are not a required part of the basic financial statements. These other supplementary schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.



June 8, 2009

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

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The Management's Discussion and Analysis section of this report is intended to serve as an introduction to the Policemen's Annuity and Benefit Fund of Chicago's financial statements and to supplement the information contained therein.

### Overview of Financial Statements and Accompanying Information

The basic financial statements are prepared in accordance with generally accepted accounting principles as established by the Governmental Accounting Standards Board (GASB) and are described below:

- **The Statements of Plan Net Assets** report the Fund's assets, liabilities and the resultant net assets where Assets minus Liabilities equal Net Assets available at the end of the year.
- **The Statements of Changes in Plan Net Assets** show the sources and uses of funds during the calendar year, where Additions minus Deductions equal the Net Increase (or Decrease) in Net Assets available for the year.
- **The Notes to the Financial Statements** are an integral part of the financial statements and include important information and schedules to provide a better understanding of the data provided in the financial statements. Information contained in the note disclosures discusses the accounting policies, benefits, contributions, fund reserves and various other relevant topics.

Due to the long-term nature of the Fund, additional information is provided to supplement the information included in the financial statements. Two required supplementary schedules for the Pension and Health Insurance, respectively, are provided that include historical trend information for the past six years for the Pension and since adoption of GASB Statement No. 43 for the Health Insurance to aid in analysis of the funded status of the plan and the progress being made in accumulating sufficient assets to pay benefits when due.

- **The Schedule of Funding Progress** contains actuarial valuations of the status of the plan in an ongoing as well as a historical basis. Actuarial Liabilities in excess of Actuarial Valuation of Assets indicates that insufficient assets have been accumulated to fund future benefits of current members and retirees.
- **The Schedule of Employer Contributions** contains historical trend information regarding the value of total annual contributions the employer must pay as determined under the parameters in GASB Statement No. 25 for the Pension and GASB Statement No. 43 for the Health Insurance and the related percentage the employer has contributed to meet its requirement.
- **The Notes to the Required Supplementary Information** provides background information and the actuarial method and assumptions used to aid in understanding the required supplementary schedules.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

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Additional schedules provided include the *Schedule of Administrative Expenses*, *Schedule of Consulting Costs* and *Schedule of Investment Fees* to reflect the costs involved in managing a defined benefit pension plan.

### Financial Highlights

- The global meltdown in financial markets in 2008 has had a drastic effect upon the assets of the Policemen's Annuity and Benefit Fund of Chicago. The U.S. stock market suffered its worse year since 1931, dropping by -37.2%. The Fund's own U.S. equity holdings fared no better, declining by -37.7% compared to an overall return of +7.5% in 2007. The international equity markets collapsed as well, ending the year down -45.5%, in sharp contrast to a +16.4% return in 2007. The Fund's own global equities declined by -46.3% in 2008 and its fixed income portfolio generated an overall return of -4.1%, compared with +5.1% for the previous year.
- The net assets of the Policemen's Annuity and Benefit Fund of Chicago decreased by \$1.33 billion or 30.7% to \$3.0 billion by year-end 2008 down from \$4.33 billion at year-end 2007. Although the drastic decline in asset value has been one of overriding concerns, the Fund's Board of Trustees and investment consultant feel that the Fund is sufficiently structured and diversified to sustain prevailing market conditions. The Fund continues to undergo a portfolio restructuring program aimed at achieving higher returns and lower volatility through greater allocation to alternative investments, including private equity, real estate, infrastructure assets, hedge fund-of-funds, and other opportunistic vehicles.
- The Fund's Management emphasizes the clear and important distinction between realized and unrealized losses. Although the Fund's unrealized losses for 2008 have been unprecedented (\$969.6 million), the realized or recognized losses for this period have been far lower (\$223.0 million). The bulk of the Fund's losses in 2008 is unrealized and therefore considered largely recoverable over time.
- The funding objective of the Plan is to meet its long-term defined pension benefit obligations. The funding ratio of the Plan on a market value basis experienced a material decrease from 51.6% at year-end 2007 to 34.7% at year-end 2008. The Fund uses a 5-year actuarial smoothing method in valuing its assets to determine its funded status and the required contributions necessary to fund the plan going forward. This actuarial valuation method reduces the effect of short-term market volatility and provides more stable trend valuation for the long-term planning needs of the Fund.
- Revenues for the Fund were consistent with 2007 except for investment income. Total contributions by the employees and employer were \$274.7 million for 2008 as compared to \$272.0 million for 2007.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

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- Expenses for the Fund continue to be dominated by benefit payments made to annuitants and disability recipients. Benefit payments for 2008, excluding death benefits and refunds, were \$489.8 million, up from \$469.7 million in 2007. Death benefits and refunds of employee deductions remained consistent from 2007 to 2008 and account for only 1.6% of total benefit expenses. The Fund's administrative expenses for 2008 were \$4.2 million, compared to \$3.1 million in 2007. Three-quarters of this increase (\$811,000) is due to the one-time cost of a new and significantly improved pension administration system. The system will be completed in 2009.
- Investment management fees decreased from \$13.7 million in 2007 to \$10.7 million in 2008, reflecting the decline in the market value of the Fund's assets under active management. The Fund's investment management fees are based upon the market value of those assets. The steep decline in the fund's portfolio value during 2008 -30.7% has resulted in a corresponding decline in investment management fees.
- The Board of Trustees has taken major steps to reduce operating and investment management expenses by restructuring its custodial and investment fee agreements. These efforts have already provided significant operating savings and will continue to do so going forward. The administrative expenses of the Fund relative to its size are low when compared to similarly-sized funds.
- The Fund's financial reporting remains in full compliance with the Governmental Accounting Standards Board (GASB). In pursuant of GASB Statement No. 45, the Fund recognizes a liability for other post-employment benefits (OPEB) which represent health insurance coverage for active and retired employees of the Fund. This obligation was disclosed in the 2007 Notes to the Financial Statements and is being recognized as an accrued expense in the amount of \$344,600 in 2008.
- Effective January 1, 2008, the Fund implemented the provisions of GASB Statement No. 50. GASB Statement No. 50 requires that information about the funded status of each pension plan as of the most recent actuarial valuation be disclosed in the notes to the financial statements. Additionally, GASB Statement No. 50 requires disclosure of information about actuarial methods and assumptions used in valuations on which reported information about the ARC and the funded status and funding progress are based. The required schedules of funding progress immediately following the notes to the financial statements present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)**

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**Plan Net Assets**

A summary of the Plan's Net Assets is presented below:

**Plan Net Assets  
(In millions)  
As of December 31, 2008 and 2007**

	<u>2008</u>	<u>2007</u>	<u>2008-2007</u> <u>Change</u>	
			<u>\$</u>	<u>%</u>
Short-term instruments	\$ 165.9	\$ 136.7	\$ 29.2	21.4%
Receivables	197.9	195.1	2.8	1.4
Brokers – unsettled trades	359.4	205.9	153.5	74.6
Investments, at fair value	2,681.4	4,051.8	(1,370.4)	-33.8
Invested securities lending collateral	<u>287.6</u>	<u>516.0</u>	<u>(228.4)</u>	-44.3
Total assets	<u>3,692.2</u>	<u>5,105.5</u>	<u>(1,413.3)</u>	
Brokers – unsettled trades	393.2	251.3	141.9	56.5
Securities lending payable	292.6	516.0	(223.4)	-43.3
OPEB Obligation	0.3	0.0	0.3	100.0
Accounts payable and accrued expenses	<u>5.1</u>	<u>5.0</u>	<u>0.1</u>	2.0
Total liabilities	<u>691.2</u>	<u>772.3</u>	<u>(81.1)</u>	
Net Plan Assets	<u>\$ 3,001.0</u>	<u>\$ 4,333.2</u>	<u>\$ (1,332.2)</u>	

Net decrease of plan net assets was \$1.33 billion in 2008, coming off a \$141.1 million increase in 2007. Widespread dislocation in U.S. and global financial markets produced a material decrease in the fair value of investments for 2008.

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)**

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**Changes in Plan Net Assets**

The following table reflects a comparative summary of various changes in Plan Net Assets.

**Changes in Plan Net Assets  
(In millions)  
Years Ended December 31, 2008 and 2007**

	2008	2007	2008-2007 Change	
			\$	%
<b>Additions:</b>				
Member contributions	\$ 93.2	\$ 93.3	\$ (0.1)	-0.1%
Employer contributions	181.5	178.7	2.8	1.6
Net investment gains (losses) and investment income	(1,104.4)	347.8	(1,452.2)	-417.5
Securities lending income (loss)	(0.5)	2.1	(2.6)	-123.8
Miscellaneous income	<u>0.2</u>	<u>0.0</u>	<u>0.2</u>	100.0
Total additions	<u>(830.0)</u>	<u>621.9</u>	<u>(1,451.9)</u>	
<b>Deductions:</b>				
Annuity and disability benefits	\$ 491.6	\$ 471.5	\$ 20.1	4.3
Refunds of contributions	6.1	6.2	(0.1)	-1.6
OPEB accrued expense	0.3	0.0	0.3	100.0
Administrative expenses	<u>4.2</u>	<u>3.1</u>	<u>1.1</u>	35.5
Total deductions	<u>502.2</u>	<u>480.8</u>	<u>21.4</u>	
Net Increase	<u>\$ (1,332.2)</u>	<u>\$ 141.1</u>	<u>\$ (1,473.3)</u>	

**Revenues – Additions to Plan Net Assets**

- Member contributions decreased slightly from \$93.3 million in 2007 to \$93.2 million in 2008. This marginal decrease reflects the net decline in participants of 375 (from 13,748 at 2007 year-end to 13,373 at 2008 year-end). Additionally, there have been no contract increases for active membership in 2008 since the previous employment contract ended June 30, 2007.
- Employer contributions increased from the prior year by 1.6% from \$178.7 million received in 2007 to \$181.5 million received in 2008. Employer contributions are mandated by a statutorily set multiplier of 2.0 times member contributions collected two years prior. Since member contributions increased marginally two years prior, due to retroactive annuity adjustments from a new contract, the employer contribution increased slightly in 2008.
- The net loss on total investment activity was (\$1,104.4) million in 2008, compared to net income of \$347.8 million in 2007. The decrease was due to a collapse in the financial markets, particularly in the last quarter of 2008. Net investment activity decreased due to a reversal in market appreciation in 2008, which produced a -27.8% return for the year compared to a +8.8% return for 2007.



## MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

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### Expenses – Deductions from Plan Net Assets

- Pension, disability and death benefits rose from \$471.5 million in 2007 to \$491.6 million in 2008, an increase of 4.3%. The increase in benefits is chiefly attributable to the 3% automatic cost-of-living increase payable to those annuitants eligible to receive it.

### Plan Membership

The following table reflects the changes in plan membership from year-end 2007 to year-end 2008.

#### Changes in Plan Membership As of December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>	<u>Change</u>	<u>%</u>
Retirees and beneficiaries receiving benefits	12,183	12,135	48	0.4%
Active employees	13,373	13,748	(375)	-2.7
Terminated (inactive members) employees entitled to benefits or refunds of contributions	<u>636</u>	<u>554</u>	<u>82</u>	<u>14.8</u>
Total	<u>26,192</u>	<u>26,437</u>	<u>(245)</u>	<u>-0.9%</u>

### Funding Status

The actuarial value of assets, using the GASB 25 and 43 methods, for the December 31, 2008, valuation was \$4.09 billion and the actuarial liability was \$8.65 billion. The actuarial liability increased significantly by \$253.2 million in 2008, from \$8.4 billion in 2007 to \$8.65 billion in 2008. The assets currently fund 47.3% of this liability, a decrease from the 50.4 % funded ratio in 2007. The decrease in the funded ratio largely resulted from the collapse in U.S. and global financial markets. As markets are expected to recover as they have in other historically significant downturns, the Fund expects a more positive trend to return to the funded ratio above its actuarial assumption of long-term rate of return of 8%.

The Board of Trustees is very concerned with the investment results of 2008 and will continue to monitor the financial situation moving into 2009. A recession of this magnitude may persist for an extended period of time. The Board has taken steps to ensure a sufficient level of liquidity within the portfolio to fund monthly benefits while pursuing its long-term goal of diversification towards alternative assets. The Board has and will continue to prudently provide the necessary resources to fund those monthly benefits while also minimize the absorption of unrealized losses in its public equity holdings.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

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### Pension Commission

In late 2007, the Mayor of the City of Chicago announced the formation of a special Pension Commission to propose ways to improve the financial strength of the City's four pension funds. Even before the current upheaval in the financial markets, the Fund had been experiencing a drag on its funding progress from negative cash flow which threatened its long-term stability. Negative cash flow occurs when employee and employer contributions are not sufficient to fund annuitant benefits, requiring the Fund to tap into its investment portfolio to augment these contributions.

The executive directors from each of the four City pension funds, as well as an elected trustee from each pension, have been serving on this mayoral commission. Several union-appointed representatives and private-sector business leaders also serve on the commission. The overriding goal of the Pension Commission is to provide specific recommendations to the City of Chicago, as plan sponsor, and the fund members, on steps that may be taken to improve the overall funding of the city plans. The commission is expected to issue a recommendation in 2009.

### Investment Activities

The Fund has continued to reallocate resources to alternative investments. In 2008, two allocations of \$40 million each were made to hedge fund-of-fund managers. The Fund committed an additional \$100 million to real estate managers. The Fund increased its allocation to private equity by an additional \$40 million. And the Fund has begun to evaluate opportunistic investments. The Fund achieved much of this reallocation through the termination of two managers. By year-end 2008, the Board of Trustees, working closely with its investment consultant, had arrived at new longer-term target allocations: U.S. Equities 33%, International Equities 18%, Fixed Income 20%, Private Equity 7%, Real Estate 7%, Opportunistic 10%, and Infrastructure 5%. The asset allocation during year-end 2007 was 45% of assets invested in domestic equity, 15% in international equity, 30% invested in fixed income, 4% in private equity, 5% in real estate and 1% in infrastructure investments.

### Investment Returns Years Ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Total Fund	(27.8%)	8.8%
Benchmark portfolio @EKA Public Fund Index	(25.7%)	7.9%
Domestic equities Benchmark (DJ Wilshire 5000)	(37.7%)	7.5%
International equities Benchmark (MSCI All-Country)	(46.3%)	16.4%
Fixed income Benchmark (Barclays Capital Aggregate)	(4.1%)	5.1%
	5.2%	7.0%

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Unaudited)

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### Effects of Economic Factors

The financial position of the plan, which has been fairly stable in recent years, has been no doubt shaken by recent market developments. The actual portfolio return of -27.8% in 2008 is unprecedented in the Fund's history and drastically lags the 8.0% actuarial rate of return, but the hope for eventual market stabilization and recovery remains strong. The Fund has been in existence since 1887 and has always fulfilled its obligation to its annuitants and their families.

### Contact Information

This financial report is designed to provide the employer, plan participants and others with a general overview of the Plan's finances and to show accountability for the monies received. Questions concerning any data provided in this report can be submitted to:

Mr. John J. Gallagher, Jr.  
Executive Director  
Policemen's Annuity and Benefit  
Fund of Chicago  
221 N. LaSalle  
Suite 1626  
Chicago, IL 60601

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**  
(A Component Unit of the City of Chicago)  
Statements of Plan Net Assets  
As of December 31, 2008 and 2007

	2008	2007
<b>ASSETS</b>		
Cash	\$ 250	\$ 250
<i>Receivables:</i>		
Employer tax levies, net of allowance for loss of \$16,071,614 in 2008 and \$14,812,131 in 2007	184,583,494	175,156,206
Member contributions	4,568,185	8,338,948
Interest and dividends	8,705,209	11,569,438
Accounts receivable—due from brokers	359,458,397	205,888,263
	557,315,285	400,952,855
<i>Investments at fair value:</i>		
U.S. Common stock and other equity	958,142,235	1,603,774,230
Collective investment, stock	186,929,884	334,686,255
Collective investment, fixed income	297,275,551	297,077,039
International equity	445,987,186	717,502,770
Bonds and notes	469,517,596	882,980,818
Short-term instruments	165,898,425	136,713,405
Infrastructure	17,378,111	8,263,605
Hedge fund-of-funds	69,937,800	-
Real estate	86,035,448	65,241,080
Venture capital	150,183,393	142,311,495
	2,847,285,629	4,188,550,697
Invested securities lending cash collateral	287,600,269	516,052,543
Total Assets	3,692,201,433	5,105,556,345
<b>LIABILITIES</b>		
Refunds and accounts payable	5,075,246	4,958,163
Trade accounts payable—due to brokers	393,161,289	251,311,712
Securities lending cash collateral	292,621,917	516,052,543
OPEB Obligation	344,600	-
Total Liabilities	691,203,052	772,322,418
Net assets held in trust for pension benefits (A schedule of funding progress is presented on page 33)	\$ 3,000,998,381	\$ 4,333,233,927

The accompanying notes are an integral part of these financial statements.

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**

(A Component Unit of the City of Chicago)

Statements of Changes in Plan Net Assets

For the Years Ended December 31, 2008 with and 2007

	2008	2007
<b>ADDITIONS</b>		
<i>Contributions:</i>		
Employer	\$ 181,526,448	\$ 178,678,154
Plan member salary deductions	93,207,408	93,299,996
Total contributions	<u>274,733,856</u>	<u>271,978,150</u>
Investment (loss) income:		
Net (depreciation) appreciation in fair value of investments	(1,187,618,379)	265,358,442
Interest	36,659,393	53,094,326
Dividends	54,994,319	42,467,732
Real estate income	3,006,892	1,564,726
	<u>(1,092,957,775)</u>	<u>362,485,226</u>
<i>Investment Activity Expenses:</i>		
Investment management fees	(10,695,551)	(13,657,186)
Custodial fees	(217,885)	(661,616)
Investment consulting fees	(563,110)	(360,649)
Total investment activity expenses	<u>(11,476,546)</u>	<u>(14,679,451)</u>
Net (loss) income from investing activities	<u>(1,104,434,321)</u>	<u>347,805,775</u>
<i>From Securities Lending Activities:</i>		
Net depreciation in fair value of investments	(5,080,033)	-
Securities lending income	13,376,393	33,941,848
Borrower rebates	(7,840,877)	(31,143,858)
Bank fees	(930,628)	(689,609)
Net (loss) income from securities lending activities	<u>(475,145)</u>	<u>2,108,381</u>
Total net investment (loss) income	<u>(1,104,909,466)</u>	<u>349,914,156</u>
Miscellaneous income	159,543	27,821
Total Additions	<u>(830,016,067)</u>	<u>621,920,127</u>
<b>DEDUCTIONS</b>		
Pension and disability benefits	489,823,660	469,723,677
Death benefits	1,779,200	1,754,836
Refunds of employee deductions	6,118,449	6,206,813
	<u>497,721,309</u>	<u>477,685,326</u>
Administrative expenses	4,153,570	3,077,073
OPEB expense	344,600	-
Total Deductions	<u>502,219,479</u>	<u>480,762,399</u>
<b>Net (Decrease) Increase</b>	(1,332,235,546)	141,157,728
Net assets held in trust for pension benefits:		
Beginning of year	<u>4,333,233,927</u>	<u>4,192,076,199</u>
<b>End of year</b>	<u>\$ 3,000,998,381</u>	<u>\$ 4,333,233,927</u>

The accompanying notes are an integral part of these financial statements.

## **POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**

(A Component Unit of the City of Chicago)

Notes to Financial Statements

December 31, 2008 and 2007

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### **NOTE 1      SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### Reporting Entity

Accounting principles generally accepted in the United States as established by the Governmental Accounting Standards Board ("GASB") define a financial reporting entity as consisting of the primary government and its component units for which the primary government is financially accountable. Financial accountability includes appointing a voting majority of a component unit's governing board, the ability of the primary government to impose its will on the component unit, or a potential for the component unit to provide specific financial benefits to or to impose specific financial burdens on the primary government. A primary government may also be financially accountable for its component units that are fiscally dependent on it.

Based on the above criteria, the Policemen's Annuity and Benefit Fund of Chicago (the "Fund" or "PABF") is considered to be a component unit of the City of Chicago (the "City"). The Fund is part of the City's financial reporting entity, and it is included in the City's pension trust funds' financial statements.

#### Basis of Accounting

The Fund's financial statements are prepared on the accrual basis of accounting. Employee and employer contributions are recognized as additions in the period in which employee services are performed. Benefits and refunds are recognized as deductions when payable. Expenses are recorded when the corresponding liabilities are incurred, regardless of when payment is made.

#### Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results may differ from those estimates.

#### Investments

The Fund is authorized to invest in bonds, notes, and other direct obligations of the United States Government and United States Government agencies; corporate bonds, debentures, and notes; certain notes secured by mortgages, including pass-through securities; common and preferred stocks; certain pooled funds; and other types of investment vehicles as set forth in the Illinois Compiled Statutes.

## POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO

(A Component Unit of the City of Chicago)

Notes to Financial Statements

December 31, 2008 and 2007

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### NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

#### Method Used to Value Investments

Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Fixed income securities are valued principally using quoted market prices provided by independent pricing services. For collective investments, the net asset value is determined and certified by the investment managers as of the reporting date. Real estate investments are valued by appraisals. Hedge fund, venture capital, infrastructure, and certain opportunistic investments do not have established quoted market prices and are reported at estimated fair value as determined by money managers.

#### Furniture and Office Equipment

Furniture and office equipment are not capitalized as they are immaterial and are charged to expenses in the year of purchase.

#### Administrative Expenses

Administrative expenses are recorded as incurred and budgeted and approved by the Board of Trustees of the Fund. Administrative expenses are funded by the employer contributions.

#### Securities Lending Transactions

Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets in the statements of plan net assets at fair value. Securities received as collateral are reported as assets only if the Fund has the ability to pledge or sell them without a borrower default. Liabilities resulting from these transactions are reported in the statements of plan net assets. The costs of securities lending transactions are reported as deductions in the statements of changes in plan net assets at gross amounts.

#### GASB Statement No. 50

Effective January 1, 2008, the Fund implemented the provisions of GASB 50. GASB 50 requires that information about the funded status of each pension plan as of the most recent actuarial valuation be disclosed in the notes to the financial statements. Additionally, GASB 50 requires disclosure of information about actuarial methods and assumptions used in valuations on which reported information about the ARC and the funded status and

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**

(A Component Unit of the City of Chicago)

Notes to Financial Statements

December 31, 2008 and 2007

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**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** *(continued)*

funding progress are based. The required schedules of funding progress immediately following the notes to the financial statements present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

**NOTE 2 PENSION PLAN**

Plan Description and Contribution Information

The Policemen's Annuity and Benefit Fund of Chicago is the administrator of a defined benefit, single-employer pension plan with a defined contribution minimum for the purpose of providing benefits to the policemen of the City of Chicago, their widows, and their children. Any employee of the City employed under the provisions of the municipal personnel ordinance as police service is covered by the Fund. The defined benefits as well as the employer and employee contribution levels are mandated in Illinois Compiled Statutes (40 ILCS Act 5, Article 5) and may be amended only by the Illinois State Legislature. The Fund is governed by an eight-member Board of Trustees (four appointed by the City, three elected by the policemen, and one elected by the annuitants) whose duties are to administer the Fund under the Illinois Pension Code.

The City of Chicago payrolls for employees covered by the Fund for the years ended December 31, 2008 and 2007, were \$1,023,580,667 (unaudited) and \$1,038,957,026, (unaudited) respectively. At December 31, 2008 and 2007, the Fund membership consisted of the following (unaudited):

	<u>2008</u>	<u>2007</u>
Active employees	13,373	13,748
Retirees and beneficiaries currently receiving benefits	12,183	12,135
Terminated employees entitled to benefits or a refund of contributions but not yet receiving them	<u>636</u>	<u>554</u>
	<u>26,192</u>	<u>26,437</u>

The Fund provides retirement benefits as well as death and disability benefits. Employees age 50 or more with at least 10 years of service are entitled to receive a money purchase annuity and partial City contributions if



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**NOTE 2**      **PENSION PLAN** (*continued*)

less than 20 years of service have been completed. Effective in 2003, the mandatory retirement age for a participant is 63. Employees age 50 or more with at least 20 years of service are entitled to receive a minimum formula annuity of 2.5% per year for the first 20 years of service plus 2.5% per year for each following year or fraction thereof times the final average salary (highest average annual salary for any 4 consecutive years within the last 10 years of service immediately preceding the date of retirement). The annuity shall not exceed 75% of the highest average annual salary.

The monthly annuity is increased by 3% of the original annuity at the first of the month following the later of the attainment of age 55 or the first anniversary of retirement, and by 3% on each January 1 thereafter, if born before January 1, 1955.

If born after January 1, 1955, then the monthly annuity is increased by 1.5% of the original annuity at the first of the month following the later of the attainment of age 60 or the first anniversary of retirement, and 1.5% on each January 1 thereafter, but not to exceed a total of 30%.

Covered employees are required to contribute 9.0% of their salary to the Fund. If an employee leaves covered employment without qualifying for an annuity, accumulated contributions are refunded with interest. The City is required by state statutes to contribute the remaining amounts necessary to finance the requirements of the Fund. It is required to levy a tax at a rate not more than an amount equal to the total amount of contributions by the employees to the Fund made in the calendar year two years prior to the year for which the annual applicable tax is levied, multiplied by 2.00 annually.

The total annual actuarial required contribution to the Fund (financed by the employees and the City) is equal to the normal cost plus interest only on the unfunded actuarial accrued liabilities determined using the entry age normal method. This actuarial cost method amortizes the costs of the participants' benefits over the entire career of each member as a level of percentage of compensation. The employer contribution required for interest only on the unfunded actuarial accrued liabilities results in a decreasing annual employer cost expressed as a percentage of payroll as future payrolls increase. Since the tax levy is expressed as a multiple of the total salary deductions made two years prior, the City is effectively contributing a level annual percentage of payrolls.

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**NOTE 2 PENSION PLAN** *(continued)*

Funded Status and Funding Progress (Unaudited)

The funded status of the Fund as of December 31, 2008, the most recent actuarial valuation date, is as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability ("AAL") Entry Age (b)	Unfunded AAL ("UAAL") (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
12/31/08	\$4,093,719,894	\$8,482,574,033	\$4,388,854,139	48.26%	\$1,023,580,667	428.77%
12/31/07	4,231,681,817	8,220,352,638	3,988,670,821	51.48	1,038,957,026	383.91

The schedule of funding progress, presented as required supplementary information ("RSI") following the notes to the financial statements, present multiyear trend information about whether the actuarial values of Fund assets are increasing or decreasing over time relative to the AALs for benefits.

Additional information as of the latest actuarial valuation follows:

Valuation date	12/31/2008
Actuarial cost method	Entry age
Amortization method	Level percent open
Remaining amortization period	30 years
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rate of return	8.0%
Projected salary increases	4.0% per year, plus additional percentage related to service
Cost of living allowance	3.0% (1.50% for retirees born after January 1, 1955)

**NOTE 3 HEALTH INSURANCE SUPPLEMENT**

Plan Description and Contribution Information

The City offers group health benefits to annuitants and their eligible dependents through the City's health care plans.

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**NOTE 3 HEALTH INSURANCE SUPPLEMENT** *(continued)*

Premiums are set by the City with the City paying 50% of the claims or premiums, whichever are applicable, and the remaining amount to be paid by all annuitants participating in the plans. Currently, the Fund pays to the City on behalf of each of the annuitants who chooses to participate in any of the City's health care plans up to a maximum of \$85 per month from July 1, 2003, through June 30, 2008, and \$95 per month from July 1, 2008, through June 30, 2013, for each annuitant who is not qualified to receive Medicare benefits; and up to a maximum of \$55 per month from July 1, 2003, through June 30, 2008, and \$65 per month from July 1, 2008, through June 30, 2013, for each annuitant who is qualified to receive Medicare benefits.

The health insurance supplement is financed with current contributions on a pay-as-you-go basis. There is no separate healthcare account established by the Fund to pay the health insurance supplement.

At December 31, 2008 and 2007, the number of annuitants or surviving spouses who have subsidized health insurance totaled 10,017 and 9,890, respectively. The annual required contribution represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years. The estimated City contribution represents the expected benefit payments for the health insurance supplement. In 2008 and 2007, the Fund received contributions of \$8,850,186 and \$8,107,708 from the City, and remitted contributions of insurance premiums to the City of \$8,850,186 and \$8,107,708, respectively. Contributions to the health insurance supplement equal to insurance premium payments to the City. There are no net assets to report for the health insurance supplement at December 31, 2008 or 2007.

Funded Status and Funding Progress (Unaudited)

The funded status of the Fund as of December 31, 2008, the most recent actuarial valuation date, is as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability ("AAL") Entry Age (b)	Unfunded AAL ("UAAL") (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
12/31/08	\$ -	\$ 169,972,156	\$ 169,972,156	0.00%	\$1,023,580,667	16.61%
12/31/07	-	179,039,841	179,039,841	0.00	1,038,957,026	17.23

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**NOTE 3 HEALTH INSURANCE SUPPLEMENT** *(continued)*

The schedule of funding progress, presented as required supplementary information ("RSI") following the notes to the financial statements, present multiyear trend information about whether the actuarial values of Fund assets are increasing or decreasing over time relative to the AALs for benefits.

Additional information as of the latest actuarial valuation follows:

Valuation date	12/31/2008
Actuarial cost method	Entry age
Amortization method	Level percent open
Remaining amortization period	30 years
Asset valuation method	No assets (Pay-as-you-go)
Actuarial assumptions:	
OPEB investment rate of return	4.5%
Projected salary increases	4.0% per year, plus additional percentage related to service
Health cost trend rate	0.0%

**NOTE 4 CASH AND INVESTMENT RISK**

Cash

The bank balance and carrying amount of the Fund's deposits, excluding \$250 of petty cash, at December 31, 2008, were \$863,116 and (\$828,761), respectively; and they were \$524,732 and (\$1,112,586) at December 31, 2007, respectively. The entire bank balance at December 31, 2008 and 2007, is on deposit with the City Treasurer and is insured or collateralized by securities held by the City Treasurer in the Fund's name.

Investment Policy

The Fund's overall investment policy is based on the following principles established by the Trustees:

- Maintain a long-term investment horizon for the Fund
- Emphasize equity investments to enhance long-term return
- Diversify investments across several asset classes
- Avoid market-timing strategies

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**NOTE 4 CASH AND INVESTMENT RISK** *(continued)*

In order to minimize the impact of large losses and to reduce annual variability of returns, the Fund's assets are allocated across major asset classes and diversified broadly within each asset class.

Investment Summary

The following table presents a summary of the Fund's investments by type at December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
US Government and agency fixed income	\$ 226,332,190	\$ 377,137,151
US corporate fixed income	243,185,406	505,843,667
US common collective fixed income funds	297,275,551	297,077,039
US equities	958,142,235	1,603,774,230
US common collective stock funds	186,929,884	334,686,255
Foreign equities	445,987,186	717,502,770
Pooled short-term investment funds	73,208,119	63,487,605
Infrastructure	17,378,111	8,263,605
Real estate	86,035,448	65,241,080
Private equity	150,183,393	142,311,495
US miscellaneous	-	17,323,000
US Treasury bills	-	4,192,072
Hedge fund-of-funds	69,937,800	-
SWAPS	701,587	178,465
Cash and cash equivalents	91,988,719	51,532,263
Total investments at fair value	<u>\$ 2,847,285,629</u>	<u>\$ 4,188,550,697</u>

Investment Risks

The Fund's investments are subject to certain types of risks, including interest rate risk, credit risk, custodial credit risk, concentration of credit risk, and foreign currency risk. The following describes those risks:

*Interest Rate Risk*—Interest rate risk is the risk that the fair value of debt securities decreases due to increases in the prevailing market interest rate. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The Fund manages its

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**NOTE 4 CASH AND INVESTMENT RISK** *(continued)*

exposure to fair value loss arising from increasing interest rates by complying with the following policy: all fixed income investments must be managed by external money managers. The Fund employed six such managers in 2008 and seven managers during 2007. The specific guidelines for each manager require that the manager be responsible for determining the maturities for all fixed income securities in their portfolio. Additionally, the Fund's policy in managing its exposure to interest rate risks is to purchase a combination of shorter term and longer term investments and to time cash flow from maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

The following tables show the segmented time distribution of the Fund's investments into time periods of maturities based on the investments' cash flows.

At December 31, 2008, the Fund had the following investments and maturities related to certain fixed income securities (bonds and notes):

Investment Type	Market Value	Investment Maturities			
		Less than 1 Year	1 to 6 Years	7 to 10 Years	More than 10 Years
Asset backed securities	\$ 41,488,871	\$ 203,453	\$ 23,949,417	\$ 5,996,521	\$ 11,339,480
Commercial mortgage backed securities	39,671,716	-	-	751,797	38,919,919
Corporate bonds	141,400,932	2,266,531	52,164,270	49,394,497	37,575,634
Government agency securities	15,699,981	-	8,594,980	1,659,303	5,445,698
Government bonds	39,311,798	2,001,771	3,261,405	11,152,109	22,896,513
Government mortgage backed securities	170,985,707	-	709,798	15,664,365	154,611,544
Guaranteed fixed income	1,961,176	-	1,961,176	-	-
Municipal principal bonds	334,704	-	-	-	334,704
Non-government backed collateralized mortgage obligations	<u>18,662,711</u>	<u>-</u>	<u>758,863</u>	<u>3,811,578</u>	<u>14,092,270</u>
Total	<u>\$ 469,517,596</u>	<u>\$ 4,471,755</u>	<u>\$ 91,399,909</u>	<u>\$ 88,430,170</u>	<u>\$ 285,215,762</u>

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**NOTE 4 CASH AND INVESTMENT RISK** *(continued)*

At December 31, 2007, the Fund had the following investments and maturities:

Investment Type	Market Value	Investment Maturities			
		Less than 1 Year	1 to 6 Years	7 to 10 Years	More than 10 Years
Asset backed securities	\$ 48,852,205	\$ 765,962	\$ 24,383,941	\$ 3,425,767	\$ 20,276,535
Commercial mortgage backed securities	92,647,231	-	-	530,263	92,116,968
Corporate bonds	250,749,025	13,185,343	100,396,930	75,442,329	61,724,423
Government agency securities	38,422,214	1,459,913	23,384,537	11,059,467	2,518,297
Government bonds	96,357,798	504,141	42,796,094	18,365,749	34,691,814
Government mortgage backed securities	232,095,695	-	2,021,527	22,769,488	207,304,680
Index linked government bonds	6,434,659	-	699,405	-	5,735,254
Municipal principal bonds	3,826,786	-	-	480,728	3,346,058
Non-government backed collateralized mortgage obligations	<u>113,595,205</u>	<u>623,935</u>	<u>-</u>	<u>5,326,893</u>	<u>107,644,377</u>
Total	<u>\$ 882,980,818</u>	<u>\$ 16,539,294</u>	<u>\$ 193,682,434</u>	<u>\$ 137,400,684</u>	<u>\$ 535,358,406</u>

*Credit Risk*—Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. This credit risk is measured by the credit quality ratings issued by national ratings agencies such as Moody's and Standard & Poor's. The Fund's investment policy limits its investments in corporate bonds to those that are rated Baa or better by nationally recognized rating agencies.

The following table provides information on the credit ratings associated with the Fund's investments in debt securities. Rates were obtained from Standard & Poor's:

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**NOTE 4 CASH AND INVESTMENT RISK** *(continued)*

	Fair Value	
	2008	2007
Quality Rating:		
AAA	\$ 70,656,569	\$ 304,053,978
AA	5,541,401	60,524,815
A	68,466,924	61,527,498
BBB	62,636,066	92,786,236
BB	4,240,319	17,115,783
B	2,405,289	28,248,182
Not rated	26,573,859	77,890,384
Other	2,664,979	3,622,904
Total credit risk of US corporate fixed income	243,185,406	645,769,780
US Government and agency fixed income securities	226,332,190	237,211,038
	\$ 469,517,596	\$ 882,980,818

*Custodial Credit Risk*—For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Fund will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the Fund, and are held by either the counterparty or the counterparty's trust department or agent but not in the Fund's name. The Fund's master custodian holds all investments of the Fund in the Fund's name. As of December 31, 2008 and 2007, deposits of \$517,839 and \$1,704,739, were exposed to custodial credit risk as uninsured and uncollateralized.

*Concentration of Credit Risk*—The Fund's investment policy limits the aggregate amount that can be invested in each asset class. Long-term allocation targets at December 31, 2008, were as follows: US equities 33%, international equities 18%, fixed income 20%, private equity 7%, real estate 7%, opportunistic 10%, and infrastructure 5%. The asset allocation targets for the year ended December 31, 2007, were as follows: 45% of assets invested in domestic equity, 15% in international equity, 30% invested in fixed income, 4% in private equity, 5% in real estate, and 1% in infrastructure investments.

The Fund has no significant investments in any organization that represent 5% or more of net assets held in trust for pension benefits.

*Foreign Currency Risk*—This is the risk that changes in exchange rates will adversely affect the fair value of an investment. International equity securities purchased by the Fund meet exchange listing requirements, and all foreign equities held by the Fund are denominated in US dollars.



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**NOTE 4 CASH AND INVESTMENT RISK (continued)**

The Fund does not have a formal investment policy governing foreign currency risk but does manage its exposure to loss in the fair value of assets by requiring managers of foreign investments to maintain diversified portfolios in order to minimize foreign currency and security risk. The fund's exposure to foreign currency risk is as follows:

	Fair Value	
	2008	2007
<u>Currency</u>		
Australian Dollar	\$ 12,062,499	\$ 28,439,364
Brazilian Real	1,188,161	2,809,428
British Pound Sterling	57,807,165	98,282,762
Canadian Dollar	13,899,826	23,891,877
Czech Koruna	(2,103,706)	1,097,173
Danish Krone	4,219,171	3,914,486
Egyptian Pound	276,976	2,432,630
Euro Currency Unit	104,078,408	189,299,832
Hong Kong Dollar	18,969,862	43,589,740
Hungarian Forint	32,190	669,211
Indian Rupee	1,904,608	5,672,056
Indonesian Rupiah	1,504,286	4,325,303
Israeli Shekel	543,900	653,150
Japanese Yen	63,409,406	108,613,550
Malaysian Ringgit	481,555	6,285,987
Mexican Peso	1,449,749	2,292,091
New Taiwan Dollar	-	14,638,415
Norwegian Krone	1,221,275	6,936,939
Polish Zloty	133,450	660,528
Singapore Dollar	3,168,558	7,749,478
South African Rand	1,580,239	8,570,121
South Korean Won	2,623,045	12,499,164
Swedish Krona	6,197,952	12,458,757
Swiss Franc	43,906,396	67,286,249
Taiwan Dollar	4,404,600	-
Thia Baht	263,839	769,123
Turkish Lira	1	1,370,937
Total investments in foreign currency	\$ 343,223,411	\$ 655,208,351

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**NOTE 4 CASH AND INVESTMENT RISK** *(continued)*

Derivatives

The Fund's investment managers may enter into derivative transactions as permitted by their guidelines for hedging or risk reduction, not for speculative purposes. A derivative financial instrument is an investment whose payoff depends upon the value of an underlying instrument such as bond or stock prices, a market index, or commodity prices. Derivative financial instruments involve, to varying degrees, credit risk and market risk. The Fund held fixed income future contracts of \$70,639,388 and \$12,640,840 at December 31, 2008 and 2007, respectively.

**NOTE 5 SECURITIES LENDING PROGRAM**

State statutes and Board of Trustees policies permit the Fund to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The Fund's master custodian, Northern Trust Bank, lends securities of the type on loan at year-end for collateral in the form of cash, irrevocable letters of credit or other securities of 102% for US securities. The contract with the Fund's master custodian requires it to indemnify the Fund if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the Fund for income distributions by the securities' issuers while the securities are on loan.

All securities loans can be terminated on demand by either the Fund or the borrower, although the average term of the loans is 60 days. Cash collateral is invested in the lending agent's short-term investment pool, which at year-end has a weighted-average maturity of 17 days. The relationship between the maturities of the investment pool and the Fund's loans is affected by the maturities of the securities loans made by other entities that use the agent's pool, which the Fund cannot determine. The Fund cannot pledge or sell collateral securities received unless the borrower defaults.

Loans outstanding as of December 31, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Market value of securities loaned	\$ 282,849,401	\$ 519,603,447
Market value of cash collateral from borrowers	287,600,269	516,052,543
Market value of non-cash collateral from borrowers	821,204	18,543,037

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**NOTE 5      SECURITIES LENDING PROGRAM** *(continued)*

As of December 31, 2008 and 2007, the Fund had no credit risk exposure to borrowers because the amounts owed to the borrowers exceeded the amounts owed to the Fund.

There was an unrealized loss of \$5,080,033 recorded in the financial statements for the year ended December 31, 2008, calculated based on the difference between book value of cash collateral due to borrowers under the securities lending program and the fair value of invested cash collateral under the securities lending program.

**NOTE 6      UNFUNDED INVESTMENT COMMITMENTS**

The Fund has unfunded commitments of approximately \$300 million at December 31, 2008, in connection with real estate, infrastructure, and private equity investments.

**NOTE 7      POST-RETIREMENT BENEFITS OF THE FUND—STAFF RETIREE HEALTH PLAN**

(a)      Plan Description

The Policemen's Annuity and Benefit Fund of Chicago ("PABF"), as an employer, administers a single-employer defined benefit post-retirement healthcare plan ("Staff Retiree Health Plan"). The Staff Retiree Health Plan provides lifetime health and dental care insurance for eligible retirees and their spouses through PABF's group health insurance plan, which covers both active and retired members. Currently 7 retirees are in the plan and 20 active employees could be eligible at retirement. Benefit subsidy provisions have been established by PABF's Board of Trustees. The amount of the subsidy varies based upon the retiree's years of service with PABF. These benefit subsidy provisions can be modified or terminated at the sole discretion of the PABF Board.

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**NOTE 7 POST-RETIREMENT BENEFITS OF THE FUND—STAFF RETIREE HEALTH PLAN** *(continued)*

Funding Policy

The required contribution is based on projected pay-as-you-go financing requirements. For 2008, PABF contributed \$86,000 to the plan for current premiums, plus the implicit subsidy of \$18,700. Plan members receiving benefits contributed \$27,036, or 21% of the total premiums, through their required contributions between \$72 and \$555 per month based upon their coverage.

Annual OPEB Cost and Net OPEB Obligation

PABF's annual other post-employment benefit ("OPEB") expense is calculated based on the annual required contribution of the employer ("ARC"), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years. The calculations assume an opening transition liability of \$0 as of December 31, 2007. The following table shows the components of PABF's annual OPEB cost for 2008, the amount actually contributed to the plan, and changes in PABF's net OPEB obligation to the Staff Retiree Health Plan:

	<u>2008</u>
Annual required contribution	\$ 274,600
Interest on net OPEB obligation	7,800
Adjustment to annual required contribution	<u>(5,800)</u>
Annual OPEB expense	276,600
Employer contributions made	<u>104,700</u>
Increase in net OPEB obligation	171,900
Net OPEB obligation at beginning of year	<u>172,700</u>
Net OPEB obligation at end of year	<u>\$ 344,600</u>

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**NOTE 7 POST-RETIREMENT BENEFITS OF THE FUND—STAFF RETIREE HEALTH PLAN** *(continued)*

The annual OPEB cost, the percentage of annual OPEB cost contributed to the Plan, and the net OPEB obligation for 2008 and 2007 is as follows:

<u>Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Percentage of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
12/31/2008	\$ 274,600	38%	\$ 344,600
12/31/2007	261,500	34	172,700

Funded Status and Funding Progress (Unaudited)

Based on the results of the December 31, 2007, valuation (the most recent actuarial valuation) projected to December 31, 2008, the actuarial accrued liability for benefits was \$3,239,700, none of which was funded; the covered payroll was \$1,202,700; and the ratio of unfunded actuarial accrued liability to covered payroll was 269.4%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities consistent with the long-term perspective of the calculations.

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**NOTE 7 POST-RETIREMENT BENEFITS OF THE FUND—STAFF RETIREE HEALTH PLAN** *(continued)*

In the December 31, 2008, actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included a 4.5% investment rate of return which is based upon the employer's assumed return on its assets and an annual healthcare cost trend rate of 9.0% initially, reduced by increments of 1.0 percentage point per year to an ultimate rate of 5.0% after four years. Both rates include a 4.5% general inflation assumption. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll over a period of 30 years. The projected salary increase assumption was 4%.

**NOTE 8 RESERVES**

The Fund maintains several reserves as required by the Illinois Pension Code and Board policy. The following are brief descriptions of the reserves.

City Contribution Reserve

	2008	2007
Balances at December 31	<u>\$ 1,020,868,413</u>	<u>\$ 1,922,681,788</u>

The City Contribution Reserve is maintained for the payment of the City's portion of future retirement benefits for active and inactive participants. Interest at 3% is credited to this reserve annually. When the amount of annuity for a policeman or widow is fixed, the City Contribution Reserve is charged with the amount of the present value of retirement benefit and the Annuity Payment Reserve is credited with such amount.

The City Contribution Reserve does not equal the present value of expected retirement benefits. The unfunded liability as calculated by the actuary was \$4,388,854,139 in 2008 and \$3,988,670,821 in 2007.

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**  
(A Component Unit of the City of Chicago)  
Notes to Financial Statements  
December 31, 2008 and 2007

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**NOTE 8      RESERVES** *(continued)*

Salary Deduction Reserve

	2008	2007
Balances at December 31	<u>\$ 1,118,778,431</u>	<u>\$ 1,060,202,962</u>

The Illinois Pension Code requires the Fund to maintain separate accounts for each policeman for the amounts of salary deductions with interest at 3% per year. When a policeman retires, the amount of his annuity is charged to the Salary Deduction Reserve and credited to the Annuity Payment Reserve. If a policeman takes a separation refund, his salary deductions are refunded to him and charged to the Salary Deduction Reserve. This reserve is fully funded.

Annuity Payment Reserve

	2008	2007
Balances at December 31	<u>\$ 588,854,748</u>	<u>\$ 636,950,919</u>

When the amount of annuity has been fixed, the present value of expected benefit is transferred from the City Contribution Reserve and the Salary Deduction Reserve to the Annuity Payment Reserve for the payment of annuity. All age and service annuities, widow's annuities, and refunds are charged to this reserve.

Annually, the actuary calculates the present value of all annuities. The Investment and Interest Reserve will transfer amounts to the Annuity Payment Reserve to ensure that the balance in the Annuity Payment Reserve equals the present value of annuities. This reserve is fully funded.

Prior Service Annuity Reserve

	2008	2007
Balances at December 31	<u>\$ 822,176,168</u>	<u>\$ 1,181,599,800</u>

The Prior Service Annuity Reserve is increased by the City's contributions for policemen and widows' prior service annuities and all prior service annuities payable to policemen and widows are charged to this reserve.

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**  
(A Component Unit of the City of Chicago)  
Notes to Financial Statements  
December 31, 2008 and 2007

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**NOTE 8      RESERVES** *(continued)*

Gift Reserve

	2008	2007
Balances at December 31	<u>\$ 13,835,549</u>	<u>\$ 13,530,344</u>

The Gift Reserve is maintained for gifts, grants, bequests or other amounts received by the Fund. The Board of Trustees determines the use of these funds. Interest is credited to the Gift Reserve annually.

(f)      Investment and Interest Reserve

All gains and losses from investments and investment earnings are recorded in the Investment and Interest Reserve. Interest due to the City Contribution Reserve, Salary Deduction Reserve, Prior Service Annuity Reserve, Gift Reserve, and Supplementary Payment Reserve is transferred from the Investment and Interest Reserve to those reserves.

(g)      Ordinary Death Benefit Reserve

	2008	2007
Balances at December 31	<u>\$ (14,164,303)</u>	<u>\$ (12,276,132)</u>

Amounts contributed by policemen and the City for death benefits are credited to the Ordinary Death Benefit Reserve. Death benefit payments are charged to this reserve. The Ordinary Death Benefit Reserve has a deficit of \$14,164,303 at December 31, 2008, and \$12,276,132 at December 31, 2007, respectively.

Automatic Increase Reserve

	2008	2007
Balances at December 31	<u>\$ (549,798,027)</u>	<u>\$ (469,903,156)</u>

The Automatic Increase Reserve is credited with amounts deducted from the salaries of policemen and matching contributions by the City for automatic increase in annuity with interest thereon. Payments of increased annuities and salary deduction refunds for increase in annuity are charged to this reserve. At December 31, 2008 and 2007, the Automatic Increase Reserve has a deficit of \$549,798,027 and \$469,903,156, respectively.



**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**  
 (A Component Unit of the City of Chicago)  
 Notes to Financial Statements  
 December 31, 2008 and 2007

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**NOTE 8      RESERVES** *(continued)*

Supplementary Payment Reserve

	2008	2007
Balances at December 31	\$ <u>447,402</u>	\$ <u>447,402</u>

The Supplementary Payment Reserve receives amounts transferred from the Investment and Interest Reserve for supplemental increases in annuity for certain eligible retirees. This reserve is fully funded.

Child's Annuity Reserve

Amounts contributed by the City for child's annuity are credited to the Child's Annuity Reserve, and payments of child's annuity are charged to this reserve.

Duty Disability Reserve

The Duty Disability Reserve is increased by the City's contributions for duty disability benefits, child's disability benefit and compensation annuity and decreased by the payments of these benefits.

Ordinary Disability Reserve

Amounts contributed by the City for ordinary disability benefits are credited to the Ordinary Disability Reserve. Payments of ordinary disability benefits are charged to this reserve.

Hospitalization Fund Reserve

The health care premiums are paid from the tax levies and are credited to the reserve for Group Hospitalization Fund. Premium payments to the City are charged against this reserve.

Expense Reserve

Amounts contributed toward the cost of administration are credited to the Expense Reserve while expenses of administration are charged to this reserve.

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**

(A Component Unit of the City of Chicago)

Notes to Financial Statements

December 31, 2008 and 2007

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**NOTE 9 DEFERRED COMPENSATION PLAN**

The Fund offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees of the Fund, permits them to defer a portion of their salary until future years. Participation in the plan is optional. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. The plan is managed by a third-party administrator.

The assets of the plan were placed in trust accounts with the plan administrator for the exclusive benefit of participants and their beneficiaries and are not considered assets of the Fund.

**NOTE 10 LEASE AGREEMENT**

The Fund leases its office facilities under a noncancellable agreement which expires in 2015. Office rental expense amounted to \$225,355 and \$200,217 for the years ended December 31, 2008 and 2007, respectively.

Future minimum rental payments under the office lease at December 31, 2008 are as follows:

<u>Year</u>	<u>Amount</u>
2009	\$ 229,294
2010	233,234
2011	239,258
2012	244,687
2013	248,626
Thereafter	<u>509,064</u>
	<u>\$ 1,704,163</u>

**NOTE 11 RISK MANAGEMENT**

The Fund is exposed to various risks of loss related to tort, theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Fund carries commercial insurance to reduce its exposure to risk of loss. There is no significant reduction in insurance coverage from year to year. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

**REQUIRED SUPPLEMENTARY INFORMATION**

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**

(A Component Unit of the City of Chicago)

Required Supplementary Information

Schedule of Funding Progress—Pension

For the Years Ended December 31, 2008 and 2007

(Unaudited)

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Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
12/31/03	\$ 4,039,695,590	\$ 6,581,433,250	\$ 2,541,737,660	61.38%	\$ 887,555,791	286.37%
12/31/04	3,933,031,342	7,034,271,474	3,101,240,132	55.91	874,301,958	354.71
12/31/05	3,914,431,654	7,722,737,147	3,808,305,493	50.69	948,973,732	401.31
12/31/06	3,997,990,919	7,939,561,277	3,941,570,358	50.36	1,012,983,634	389.11
12/31/07	4,231,681,817	8,220,352,638	3,988,670,821	51.48	1,038,957,026	383.91
12/31/08	4,093,719,894	8,482,574,033	4,388,854,139	48.26	1,023,580,667	428.77

The accompanying notes are an integral part of this schedule.

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**

(A Component Unit of the City of Chicago)

Required Supplementary Information

Schedule of Employer Contributions—Pension

For the Years Ended December 31, 2008 and 2007

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<u>Year Ended December 31</u>	<u>Contributions</u>			<u>Percentage Contributed</u>
	<u>Annual Required</u>	<u>Actual Employee</u>	<u>Actual Employer</u>	
2003	\$ 181,545,562	\$ 79,816,332	\$ 140,807,354	77.56%
2004	203,757,534	78,800,816	135,744,173	66.62
2005	238,423,459	89,109,811	178,278,371	74.77
2006	262,657,025	91,965,685	150,717,705	57.38
2007	312,726,608	93,299,996	170,598,268	54.55
2008	318,234,870	93,207,408	172,835,805	54.31

The accompanying notes are an integral part of this schedule.

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**

(A Component Unit of the City of Chicago)

Notes to Required Supplementary Information—Pension

December 31, 2008 and 2007

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(Unaudited)

Valuation date	December 31, 2008 and 2007, respectively
Actuarial cost method	Entry age normal
Amortization method	Level percent open
Remaining amortization period	30 years
Actuarial value of assets	5-year smoothed market
Actuarial assumptions:	
Pension investment rate of return	8.0%
Projected salary increases	4.0% per year, plus additional percentage related to service
Cost of living allowance	3.0% (1.5% for retirees born after January 1, 1955)

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**

(A Component Unit of the City of Chicago)

Required Supplementary Information

Schedule of Funding Progress—Health Insurance Supplement

For the Years Ended December 31, 2008 and 2007

(Unaudited)

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<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Accrued Liability (AAL) Entry Age (b)</u>	<u>Unfunded AAL (UAAL) (b-a)</u>	<u>Funded Ratio (a/b)</u>	<u>Covered Payroll (c)</u>	<u>UAAL as a Percentage of Covered Payroll ((b-a)/c)</u>
12/31/05	\$ -	\$ 176,117,539	\$ 176,117,539	0.00%	\$ 948,973,732	18.56%
12/31/06	-	176,981,897	176,981,897	0.00	1,012,983,634	17.47
12/31/07	-	179,039,841	179,039,841	0.00	1,038,957,026	17.23
12/31/08	-	169,972,156	169,972,156	0.00	1,023,580,667	16.61

The accompanying notes are an integral part of this schedule.

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**

(A Component Unit of the City of Chicago)

Required Supplementary Information

Schedule of Employer Contributions—Health Insurance Supplement

For the Years Ended December 31, 2008 and 2007

(Unaudited)

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<u>Year Ended December 31</u>	<u>Contributions</u>			<u>Percentage Contributed</u>
	<u>Annual Required</u>	<u>Actual Employee</u>	<u>Actual Employer</u>	
2006	\$ 11,076,022	\$ -	\$ 8,041,573	72.60%
2007	11,220,081	-	8,107,708	72.26
2008	11,348,959	-	8,850,186	77.98

The accompanying notes are an integral part of this schedule.



**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**  
(A Component Unit of the City of Chicago)  
Notes to Required Supplementary Information—Health Insurance Supplement  
December 31, 2008 and 2007

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(Unaudited)

Valuation date	December 31, 2008 and 2007, respectively
Actuarial cost method	Entry age normal
Actuarial value of assets	No assets (pay-as-you-go)
Amortization method	Level percent open
Remaining amortization period	30 years
Actuarial assumptions:	
OPEB investment rate of return	4.5%
Projected salary increases	4.0% per year, plus additional percentage related to service

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**

(A Component Unit of the City of Chicago)

Required Supplementary Information

Schedule of Funding Progress—Staff Retiree Health Plan

For the Years ended December 31, 2008 and 2007

(Unaudited)

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<u>Actuarial Valuation Date</u>	<u>GASB Value of Assets (a)</u>	<u>Actuarial Accrued Liability (AAL) Entry Age (b)</u>	<u>Unfunded AAL (UAAL) (b-a)</u>	<u>Funded Ratio (a/b)</u>	<u>Covered Payroll (c)</u>	<u>UAAL as a Percentage of Covered Payroll ((b-a)/c)</u>
12/31/07	\$ -	\$ 3,021,300	\$ 3,021,300	0.00%	\$ 1,150,900	262.5%
12/31/08	-	3,239,700	3,239,700	0.00	1,202,700	269.4

The accompanying notes are an integral part of this schedule.

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**

(A Component Unit of the City of Chicago)

Required Supplementary Information

Schedule of Employer Contributions—Staff Retiree Health Plan

For the Years Ended December 31, 2008 and 2007

(Unaudited)

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<u>Year Ended December 31</u>	<u>Contributions</u>			<u>Percentage Contributed</u>
	<u>Annual Required</u>	<u>Actual Employee</u>	<u>Actual Employer</u>	
2007	\$ 261,500	\$ -	\$ 88,800	34%
2008	274,600	-	104,700	38

The accompanying notes are an integral part of this schedule.

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**  
(A Component Unit of the City of Chicago)  
Notes to Required Supplementary Information—Staff Retiree Health Plan  
December 31, 2008 and 2007

---

(Unaudited)

Valuation date	December 31, 2008 and 2007, respectively
Actuarial cost method	Entry Age Normal
Actuarial value of assets	No Assets (Pay-as-you-go)
Amortization method	Level Percent Open
Remaining amortization period	30 Years
Actuarial assumptions:	
OPEB investment rate of return	4.5% per year
Wage Inflation	4.5% per year
Healthcare Trend	9.0% per year, graded down to 5.0% per year ultimate trend in 1.0% increments

**OTHER SUPPLEMENTARY INFORMATION**

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**

(A Component Unit of the City of Chicago)

Other Supplementary Information

Schedule of Administrative Expenses

For the Years Ended December 31, 2008 and 2007

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	<u>2008</u>	<u>2007</u>
<b>Administrative Expenses:</b>		
Personal services	\$ 1,738,915	\$ 1,542,049
Supplies	13,185	12,580
Professional services	12,081,579	15,228,160
Fiduciary insurance	111,766	110,712
Occupancy and utilities	230,468	208,338
Postage	6,000	3,000
Equipment service and rent	62,272	46,309
Benefit disbursements	233,681	193,667
Miscellaneous	<u>1,152,250</u>	<u>411,709</u>
	<u>\$ 15,630,116</u>	<u>\$ 17,756,524</u>

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**

(A Component Unit of the City of Chicago)

Other Supplementary Information

Schedule of Consulting Costs

For the Years Ended December 31, 2008 and 2007

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	<u>2008</u>	<u>2007</u>
<b>Payment to Consultants:</b>		
External auditors	\$ 45,925	\$ 55,150
Medical consultant	217,251	176,978
Legal services	240,450	215,430
Actuary service	101,407	101,151
Investment manager fees	10,695,551	13,657,186
Master trustee fees	217,885	661,616
Consulting fees	<u>563,110</u>	<u>360,649</u>
	<u>\$ 12,081,579</u>	<u>\$ 15,228,160</u>

**POLICEMEN'S ANNUITY AND BENEFIT FUND OF CHICAGO**

(A Component Unit of the City of Chicago)

Other Supplementary Information

Schedule of Investment Fees

For the Years Ended December 31, 2008 and 2007

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Ariel Capital Management	\$ 253,697	\$ 352,536
Artisan Partners	680,013	435,163
Attucks Asset Management	42,053	18,961
Capital Guardian Trust Co.	580,627	720,492
Channing Capital	148,667	185,437
Chicago Equity Partners	492,410	623,527
Cordillera Asset Management	144,770	205,578
Dearborn Partners LLC	171,345	164,960
Denali Advisors	135,582	95,806
European Investors	678	-
Great Lakes Advisors	595,058	765,474
Harris Investments	19,039	319,062
Holland Capital Management	269,124	171,427
Invesco	383,197	296,175
JP Morgan	388,016	1,374,235
LM Capital Group	71,065	67,722
McKinley Capital	432,141	515,745
Montag & Caldwell	794,282	753,689
Northern Trust Global Investments - Index Funds	133,351	154,493
Piedmont Investment Advisors	189,043	137,081
Piedra Capital Ltd.	77,932	144,606
Taplin, Canida, & Habacht	118,768	118,154
UBS Asset Management	1,692,687	2,846,904
Wellington Management	416,630	418,221
Wells Capital Management	355,190	336,988
William Blair & Co.	2,110,186	2,421,524
Zenna Financial Services	-	13,226
Total investment managers fees	<u>10,695,551</u>	<u>13,657,186</u>
<b>Investment Consultants:</b>		
Ennis Knupp & Associates	350,375	250,419
Courtland Partners	133,208	110,230
Kolhberg & Associates	79,527	-
Total investment consultants fees	<u>563,110</u>	<u>360,649</u>
<b>Master Custodian:</b>		
The Northern Trust Company	217,885	661,616
Total investment fees	<u>\$ 11,476,546</u>	<u>\$ 14,679,451</u>